August 5, 2016

Mr. Juan Manuel Vega-Serrano
President
The Financial Action Taskforce (FATF-GAFI)
2 Rue André Pascal
75775 Paris
France

Re: FATF Consultation of the Private Sector on Correspondent Banking

Dear Mr. Vega-Serrano:

The Institute of International Finance (the "IIF" or the "Institute") is pleased to be able to respond to the request of the Financial Action Taskforce ("FATF") for feedback on its draft guidance for Correspondent Banking (the "draft guidance")[1]. As a permanent member of the FATF Private Sector Consultative Forum ("PSCF"), the IIF has long supported the goals of the FATF in promoting effective implementation of measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The Institute particularly appreciates the open-minded spirit in which the FATF has approached "de-risking" questions and the opportunity to consult on issues of utmost importance to the industry.

We thank the FATF for the detailed and lengthy work being undertaken to assist in mitigating the drivers and impacts of "de-risking" in global correspondent banking and we believe that the draft guidance represents an important contribution. While we are broadly supportive of the direction taken in producing the draft guidance, there are a number of areas where we believe further enhancements would greatly benefit its efficacy. Specifically, (i) some revision is required to ensure that the risk-based approach is well understood and effective as the main driver for compliance decision making in correspondent banking; (ii) greater emphasis should be placed on providing regulatory clarity and regulatory certainty for banks engaging in the business of correspondent banking in order to ensure the risk-based approach can be consistently and confidently applied, and to remove perceptions of a zero-tolerance regulatory environment; (iii) the ambiguity around Know Your Customers' Customer Requirements ("KYCC") is still apparent in the draft guidance and should be removed (or at least, the intent should be clarified); and (iv) further refinement is needed to ensure the draft guidance does not add unnecessary and complicated regulatory burdens on banks that may unintendedly amplify the causes of de-risking, rather than alleviating them. The need for regulatory clarity about KYCC is fundamental to resolving the issues that contribute to de-risking and comes up in response to several of the FATF's questions, in addition to the focused discussion of important KYCC-related issues in section 9 of our letter.

[1] The Financial Action Taskforce (FATF); *Consultation of the Private Sector on Correspondent Banking*, July 2016

Detailed comments on all these issues can found in this submission and we thank you for your consideration of our feedback and proposals. Should you have any questions, please do not hesitate to contact me or Matthew Ekberg (mekberg@iif.com).

Very truly yours,

David Schraa

August 5, 2016

Re: FATF Consultation of the Private Sector on Correspondent Banking

Introduction:

The IIF has been working closely with its members and the public sector to evaluate areas where members' efforts to fight financial crime may be impeded or where regulatory issues could lead to unintended consequences. This has produced discussion and specific recommendations on de-risking in correspondent banking.[2] We are pleased that the FATF has continued work in this area by producing the draft guidance with the intent to address unintended consequences of the current regime, and in particular, the legitimate concerns that de-risking may drive financial transactions into less-regulated or non-regulated channels.

We are grateful that the FATF, by developing this guidance, has recognized some of the difficulties and ambiguities that banks face in conducting the correspondent banking business, particularly rising risk-management costs, reputational risk, and uncertainty about what is required. We believe the broader discussion on finding workable solutions to de-risking encompassing, *inter alia*, the Financial Stability Board ("FSB"), the Basel Committee on Banking Supervision ("BCBS"), the Committee on Payments and Market Infrastructures ("CPMI"), the International Monetary Fund ("IMF") and the World Bank is an important global effort and one in which the private sector values taking a constructive role.

As part of that work, we present herein our feedback on the questions in the draft guidance and provide additional observations on the approach taken by the FATF. We must, however, emphasize at the outset that while producing guidance in this area is an important step forward, we are of the general view that the measures outlined - as they stand - will not fully solve the problems that may create incentives to de-risking and could indeed exacerbate the danger of unintended consequences. Some proposals, if promulgated as suggested, would further absorb resources – in particular in the correspondent banks – and subsequently cause a rise in the cost of providing these services. It is not apparent that regulatory and reputational risks would be changed substantially by the guidance. The threshold for maintaining a relationship with a respondent bank would therefore rise. Correspondent banks may find it more difficult to justify maintaining such relationships from a commercial standpoint.

Specifically, we believe there is too much emphasis placed in the draft guidance on the obligations of banks and not enough placed on the need for regulatory authorities to provide clarity and certainty for banks as to how business can be done with confidence in higher-risk situations.[3]

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[2] For further information on this issue, please see the IIF/BAFT Letter to the CPMI. December 7, 2015: https://www.iif.com/publication/regulatory-comment-letter/iifbaft-joint-response-cpmi-correspondent-banking

[3] We note that the FSB has called for "clarifying regulatory expectations, as a matter of priority…" (FSB: *Report to the G20 on actions taken to assess and address the decline in correspondent banking*, November 6, 2015, p. 2); the IMF has requested "Further clarification of, or outreach on, international standards (including by the FATF) and national regulators' expectations." (IMF: *The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action*, June 2016, p. 38) and the World Bank has asked for "an unequivocal statement from national supervisors that there won't be a zero tolerance approach for failures to detect money laundering "(World Bank: *Withdrawal from Correspondent Banking; Where, Why, and What to Do About It*, November 2015, p. 41).

There is also not enough importance given to improving understanding of the risk based approach as the primary driver for compliance considerations in this area in ways that would contain, as opposed to enhance, incentives to de-risk. In particular, there should be greater focus on how regulatory authorities and the industry can identify and implement ways to simplify the process of providing correspondent banking services from a compliance standpoint so as to provide greater assurances that inadvertent regulatory risk can be avoided.

Regulators should make clear that if the to-be-agreed standards and processes in the draft guidance (for the correspondent banks as well as the respondent banks) are followed in good faith, banks can be assured they will be found in conformity with regulatory requirements. This is essential to ensure that the perception of a zero-tolerance regulatory environment will be allayed across all jurisdictions. The best result lies in clearly defined and interpreted regulatory expectations that support effective risk management in order to operate an appropriate risk-based system. This would assist in leveling the playing field and reducing incentives for precautionary measures or unduly risk-avoiding strategies.

In addition, the draft guidance is only one part of the effort to tackle the issue of regulatory incentives to de-risking. It is equally important to address the impediments to information sharing that hamper effective and efficient compliance processes.[4] Specific challenges to effective sharing of anti-money laundering and counter-terrorist financing ("AML" and "CFT") information - such as the impact of inconsistent legal frameworks for data protection, data processing, data usage[5], and privacy across different jurisdictions – are essential to be overcome in order to improve effective compliance and reduce costs.[6]

We also continue to emphasize that all interested stakeholders should support (i) creation of Know Your Customer ("KYC") Utilities (including creating internationally agreed sound practices for such utilities, in order to facilitate banks' confident reliance upon them)[7], (ii) active consideration of other technological means to streamline correspondent banking relationships,

[4] We note that Paragraph 28 of the draft guidance recognizes that the application of data protection and privacy laws can be an obstacle to ongoing due diligence of respondent institutions. We are also encouraged by the recent G-7 statement calling for the enhancement of information exchange and cooperation (G7 Action Plan on Combatting the Financing of Terrorism; May 21, 2016). This is a significant issue that needs to be addressed to help alleviate the causes of de-risking and we are grateful for the ongoing work of the FATF in this area.

[5] This would include impediments to sharing SARs or similar information.

[6] The IIF has specifically presented recommendations to tackle the information sharing barriers that have been identified in the enterprise-wide context, among financial institutions not part of the same financial group, and between governments and the private sector: IIF, *Letter to the FATF on facilitating effective sharing of AML/CFT information*, May 25, 2016: https://www.iif.com/publication/regulatory-comment-letter/iif-submits-letter-effective-information-sharing-amlcft

[7] We note that the recent report of the CPMI on correspondent banking makes a number of productive suggestions in relation to this area and specifically calls for defining a minimum set of standards for information and data that all KYC utilities should collect and also calls on the FATF and the BCBS AML/CFT Expert Group ("AMLEG") to consider developing a set of issues that financial institutions should consider when using KYC utilities in order to foster greater regulatory reliance on the use of such utilities. The IIF welcomes these initiatives and looks forward to working with the relevant stakeholders as work progresses: CPMI, *Correspondent Banking*, July 2016.

and (iii) continued technical assistance and training in AML/CFT standards for respondent banks, particularly in emerging markets, as envisioned by the FSB[8].

Lastly, alternative channels for transactions in instances where maintaining correspondent banking relationships would entail otherwise unacceptably high levels of risk, should be made available. Governments in higher risk jurisdictions should examine the possibility of establishing and guaranteeing safe corridors to their financial systems and the regulatory authorities should provide specific regulatory assurances for financial institutions accessing jurisdictions via these corridors.

Key Issues:

1. **Definition of correspondent banking** (Para 13): *please share your views on the current FATF definition of correspondent banking (FATF Glossary). Would a change in the definition and more specifically on the scope of the definition, help financial institutions address some of the de-risking challenges, or would it cause more uncertainty? If relevant, please explain why a change in definition would help to address some of the de-risking challenges, and give your views on whether this would have a significant, moderate or minimal impact on de-risking?*

The industry has long advocated that the FATF should work toward risk-ranking the wide range of services and activities captured within the current (overly) broad definition of correspondent banking. Care should be taken to find ways to agree on a uniform, risk-based and appropriate description. Two problems need to be addressed in the definition from the point of view of correspondent banks that may be faced with decisions about de-risking: (a) the definition needs to be refocused on correspondent banking *per se* and not sweep other business relationships into the "high risk" category, and (b) it needs to be made clear that the same standards and obligations apply to money and value transfer service ("MVTS") providers or similar businesses that may in effect be providing the same services.

An overly broad definition. The current FATF definition of correspondent banking effectively implies any service provided by one bank on behalf of, or to, another is high risk. This interpretation has contributed to the uncertainty about regulatory expectations around correspondent banking. The definition should be reevaluated to reflect risk in the system more accurately. Therefore, we strongly recommend the FATF adopt the Wolfsberg Group definition of correspondent banking as a more accurate description of the true scope of the business.[9] The Wolfsberg definition provides a targeted approach that narrows the definition away from the broad spectrum of banking services provided by one bank to another bank and better allows for the gradation and understanding of risk in the relationship based on specific business lines. This

[8] We note that there has been significant discussion globally on training and capacity building. The FSB has, for example, emphasized the need for domestic capacity-building in jurisdictions that are home to impacted respondent banks. FSB: *Report to the G20 on actions taken to assess and address the decline in correspondent banking*, November 6, 2015, pp. 8-9.

[9] "Correspondent Banking is the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency"; The Wolfsberg Group, *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking,* 2014.

definition would provide greater clarity for banks engaging in correspondent relationships to determine what is expected from a regulatory review perspective.

Clarification as applied to other providers. Though we believe the Wolfsberg definition to be the best option for increasing regulatory certainty, the final definition proposed by the FATF in the draft guidance, if adopted, should include updating to encompass developments in services provided by non-banks.[10]

The draft guidance seeks to expand the definition of correspondent banking that is already part of the general glossary to the FATF Recommendations[11] in order to cover certain relationships of MVTS providers. This is appropriate. The draft guidance describes correspondent banking as "the provision of banking services by one bank (the "correspondent bank") to another bank (the respondent bank")." It further states that the correspondent banking definition "also applies to other *similar relationships* which, for the purpose of this guidance, mean MVTS acting as intermediaries." The draft guidance then uses the terms "bank" and "MVTS provider" to define "correspondent institution, and uses the term "financial institution" to define "respondent institution."

We believe that the defined terms are unnecessarily complex and confusing. Rather than referring to the terms "bank," "MVTS," and "MVTS provider," the definitions of "correspondent institution" and "correspondent banking" should incorporate the term "financial institution," in a similar way "respondent institution" is set forth in the draft guidance. The term "financial institution" is already defined in the general glossary to the FATF Recommendations, which is cross-referenced in the draft guidance.[12] Consideration should, however, be given to updating the definition to refer explicitly to MVTS providers and to "fintech" businesses such as innovative payment services providers.[13] Accordingly the draft guidance should consistently apply to correspondent banking services provided by all "financial institutions", though due consideration should be given to distinguishing traditional financial institutions from non-traditional providers, such as MVTS, as noted below.

We also believe that it would be useful to define the terms "correspondent account" and "correspondent account services." The draft guidance refers to "banking services" in the "correspondent banking" definition and provides a list of certain "services" that "respondent banks may be provided with . . . ."[14] We believe that the clarity and utility of the draft guidance would be improved by uniform use of these defined terms: "financial institution," "correspondent

[10] For the avoidance of doubt, this also applies if, as recommended, the FATF adopts the Wolfsberg definition as the basis for the definition in the final guidance.

[11] FATF: *The FATF Recommendations*, February 2012 (Updated June 2016).

[12] As noted in Paragraph 48 of the Draft Guidance "MVTS providers are *financial institutions* under the *FATF Recommendations*... ." FATF Recommendation 13 applies broadly to "financial institutions."

[13] For a brief discussion, see Committee on Payments and Market Infrastructures, *Correspondent Banking,* July 2016, p. 9, note 6.

[14] We also note, for example, that Paragraph 10 refers to "correspondent banking or respondent banking services" and "correspondent banking-type services" without defining such terms.

institution," "respondent institution," "correspondent account," and "correspondent account services."

Lastly, the draft guidance should provide more tailored guidance on correspondent services provided by "financial institutions" other than banks, *e.g.*, MVTS providers, broker-dealers, etc. It should be made clear that these provisions would apply to the emerging "fintech" businesses (such as the "innovative payment service providers" referred to by the CPMI above), where they provide such services. As discussed further herein, it will be necessary to consider the conditions under which banks can rely on such entities in their provision of their correspondent banking-type services.

Providing such guidance with respect to specific types of "respondent institutions" and types of correspondent account services should facilitate clarity, legal certainty, and the ability of correspondent and respondent institutions to comply with the expectations set forth in the draft guidance, which should help address some of the de-risking challenges faced by correspondent institutions. This would help ensure consistency of treatment and avoid the risk of regulatory arbitrage because of differences in rules applicable to different providers.

2. **Correspondent banking risk indicators** (Para 16): *please provide your views on the usefulness and relevance of the reference to the BCBS list of correspondent banking risk indicators (Guidance on Sound management of risks related to money laundering and financing of terrorism, Annex II on correspondent banking, para. 7), and suggest other possible indicators to consider when determining the risk profile of correspondent banking relationships. If some kinds of correspondent banking products or services are considered lower risk for ML/TF than others, please provide examples and explain why the ML/TF risk is lower. If this is not possible since ML/TF risk will vary on a case-by-case basis, please state such or explain.*

Gradation of risk in the assessment of correspondent banking services is essential. Correspondent banks currently gather substantial information about their respondent banks at the beginning of relationships and on a continuing basis after that in order to understand the nature of the respondent's business and correctly assess money laundering and terrorist financing risks ("ML/TF"). The reference back to the BCBS list of correspondent banking risk indicators is appropriate as they mirror the customer due diligence requirements set out in the 2014 Wolfsberg Principles.[15] We also acknowledge the statement by the FATF that it is not possible to elaborate a conclusive list of higher risk scenarios for the reasons noted. However, it would greatly benefit the utility of the draft guidance if there was explicit language allowing banks to rely on the list as *presumptively adequate* for purposes of classifying correspondent banking risk unless there is a manifest reason to apply additional due diligence. The FATF should provide as

[15] The Wolfsberg Group, *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking*, 2014.

much certainty as possible that banks can rely on established standards when conducting risk assessments.[16]

We also suggest that the FATF should consider issues with certain risk factors when transposing the BCBS list. For example, in reference to risk factor (d)[17], it is important for the draft guidance to make clear that the risk of a product is distinct from any customer risk rating. A customer is rated based on, *inter alia*, jurisdiction, supervision, customer base, ownership, management, and reputation. This assessment then drives the product and service offering. It goes without saying that offering a specific product considered to be of enhanced risk triggers specific supervision from a product perspective. Distinct analysis of the customer and of the products offered to it facilitates review of the KYC file or when AML alerts are triggered based on transactions. Overall, this facilitates supervision of counterparty and product offerings made to it.

We also question risk factor (h).[18] We believe incorporating this factor would in effect embed a KYCC requirement that would run contrary to the FATF's draft guidance in that area and contribute to the incentives to de-risking. Specifically, we question which third parties are contemplated by the risk factor and whether that implies capturing the customers' customers who are sending payment instructions to the respondent or whether it captures nested respondents. We request reconsideration of this risk factor to ensure mitigation of the unintended KYCC ambiguity.[19]

Paragraph 15 of the draft guidance notes: "Accordingly, the extent to which additional measures should be applied will vary on a case-by-case basis, depending on the level of risk, including what measures the respondent institution has implemented to mitigate its own ML/TF risks." However, the issue is not only the "level" of risk, but also the type of risk. A respondent institution could be a low money laundering risk, but a high sanctions risk, and vice versa. It could have strong AML controls, but weak sanctions controls. We believe that this distinction should be made given that sanctions risk can be country-specific rather than inherent and universal and can be mitigated in ways that ensure legal compliance while not impeding other business.

We also note that Paragraph 15 states: "Although additional Customer Due Diligence ("CDD") measures always apply to correspondent banking, correspondent banking relationships are very diverse in nature and therefore some may be higher risk than others. For example, payable through accounts relations should be classified by banks in the highest risk cluster, and lower risk correspondent banking relationships should be part of the correspondent institution's high risk spectrum." We fear this statement is confusing, could be quite expansive as to what is required, would be expensive to comply with, and would create strong disincentives to engage in low risk

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[16] We consider the statement in Paragraph 16 that "… all these factors could lead to a different conclusion about the level of risk …for these reasons there is a serious risk that trying to define what constitutes a higher risk scenario would have the unintended consequence of exacerbating the de-risking phenomenon by leading to a more rules based … approach" counterproductive, as regulatory clarity on what can be relied upon by a bank acting in good faith within the framework of the risk-based approach is what is needed to avoid de-risking.

[17] "the purpose of the services provided to the respondent bank": Basel Committee on Banking Supervision, *Sound management of risks related to money laundering and financing of terrorism*, Annex II on correspondent banking, para. 7, (d), February 2016.

[18] "the ability to obtain identity of any third-party entities that will be entitled to use the correspondent banking services:": IBID, para. 7, (h), February 2016.

[19] For additional discussion on the KYCC issue, please see section 9(d) of this comment letter.

correspondent banking business. Appropriate revision of the definition of correspondent banking would help; in addition the "high risk" spectrum should be revaluated and restated to clarify intent.

3. **Assessment of the respondent institution's AML/CFT controls** (Para. 19): *please confirm that the proposed high-level description reflects the process which correspondent institutions usually apply, and provide information on how this is being done in practice.*

We believe the description in the draft guidance reflects in broad terms the approach taken by financial institutions providing correspondent banking services. Many banks' processes are governed by the Wolfsberg Anti-Money Laundering Principles for Correspondent Banking[20] alongside specific requirements of regulators and regulatory guidance. These include not dealing with respondent banks prohibited by internal sanctions policy; enhanced due diligence on high risk correspondent relationships; and conducting business only where controls are tailored to address the financial crime risk posed by the jurisdiction, product, entity, and the client's primary business. In addition, checks are preformed that no business is being done with shell banks or banks that offer payable-through accounts or anonymous accounts, and careful review is generally undertaken by an internal committee of all new group wide correspondent banking relationships.

We do however note that Paragraph 19 states: "In practice, such an assessment could for example, involve reviewing the respondent institution's AML/CFT policies and procedures and their implementation to assess if they are in line with the applicable AML/CFT laws and regulations in the jurisdiction of the respondent institution, including targeted financial sanctions." While this suggestion is useful on one level, it does not address the risk issues of the correspondent institution as the applicable AML/CFT laws and regulations may be well below international standards applicable to the correspondent bank and thus of questionable probative value on the correspondent bank's risk assessment. In current practice, the assessment of the controls by the correspondent bank will at a minimum be against international industry standards. The intent of the draft guidance here is unclear: if international standards are expected, that should be stated. If reliance on local standards is sufficient, that needs to be made very clear to avoid creating further ambiguity.

4. **Nested relationships** (Para. 21): *please provide information and examples of:*

    - *monitoring measures applied by correspondent institutions to detect undisclosed nested relationship*
    - *process put in place by correspondent institutions to understand the respondent control framework with respect to nested relationships*

Issues with "nested" relationships. In the first instance, the use of the term "nested", which has taken on negative connotations, may distort the discussion. A better term would be "downstream clearing", which reflects a very useful feature of the traditional correspondent banking business. It is important to note (a) that "nested" accounts are both an important strategy (especially for USD

[20] The Wolfsberg Group, *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking,* 2014

payments) for emerging-market banks that do not have or have lost direct correspondent relationships for any reason (related to AML or not) and (b) much of the scaling-back that has occurred has been driven by regulatory issues about difficulties of identifying all intermediaries, originators or beneficiaries of payments through such relationships, and in some cases by specific supervisory concerns. This reflects the fact that "nested" relationships are seen as effectively equivalent to dealing with the underlying banks directly, but with less transparency of the underlying bank's activity, making the correspondent's risk management much more challenging. Withdrawal from "nested" activities is therefore driven by cost and risk (and risk appetite) as well as regulatory pressure.

To detect undisclosed "nested" relationships, banks are turning to analytical tools to assist in their review process. This may include use of a technological utility or program that focuses on end-to-end transactions (originator to beneficiary) and creates profiles of the two parties, with alerts triggered based on score values. However, this technique is not entirely reliable, as the matching of the originator and the beneficiary is very challenging and depends on the format and information submitted. Furthermore the country focus using currently available tools is mostly on the International Bank Account Number ("IBAN") and Bank Identifier Code ("BIC"), which, to an extent, limits the view of the parties to the transaction. These problems will be mitigated to a significant degree insofar as legal entities are concerned as the Legal Entity Identifier ("LEI") program is progressively implemented in the coming years, although LEIs cannot be expected to solve all the AML issues.[21] A clearer view in this area requires manual review during periodic client due diligence or when an AML alert occurs. In addition, legal or regulatory obstacles to information sharing may impede the full effectiveness of such procedures.[22]

A further issue is transactions wherein the counterparty does not fully disclose the parties of the payments in the right format. A challenge exists when transactions are transferred to a third party using the payment purpose field indicating that the payment is for "further credit". Automated detection struggles in this area, as a number of payments in this field contain invoice numbers that appear similar to account numbers.

For purposes of understanding a respondent's control framework, risk-based requests for information are often made to respondents. However, the answers do not always allow a clear view and a subsequent direct discussion with the counterparty is frequently required. As a consequence, we believe the language in the draft guidance stating "the correspondent should also ensure that it understands the respondent's control framework"[23] may be too prescriptive given what information is available, as it is often a matter of judgement at a point in time by a correspondent that the respondent control framework does or does not present a concern. The language may also imply a hidden element of KYCC which would run counter to the presumed

[21] CPMI, *Correspondent Banking*, July 2016, pp. 23-27.

[22] For further information, please see our example of obstacles to information sharing in our letter to the FATF: IIF, *Letter to the FATF on facilitating effective sharing of AML/CFT information*, May 25, 2016: https://www.iif.com/publication/regulatory-comment-letter/iif-submits-letter-effective-information-sharing-amlcft

[23] FATF Draft Guidance, Para 21.

intent of the draft guidance and would thus create further complexity and hence further incentives to de-risk unless limited and clarified.[24]

Recommendations on "nesting". The issue of "nesting" is ultimately a significant part of the KYCC challenge. With clearer regulatory guidance, the downstream clearing model should be available under appropriate circumstances to support downstream banks and their underlying customers, which would help reduce the impacts of de-risking. Improved guidance should include requirements for information transfer and transparency that can easily be understood by respondent banks and establish norms that correspondent banks can rely upon in managing their relationships. As discussed below, such guidance should extend to a clearer definition of conditions under which banks can rely upon MVTS or other providers of downstream payment services. Reform of the impediments to information sharing that have been identified would also help.[25]

Additionally, helping respondents through AML/CFT training programs can also assist in providing greater visibility into the structure of certain downstream relationships. Banks in jurisdictions with limited financial crime resources and where financial crime regulation is less stringent need to be aware of financial crime risk management programs in developed jurisdictions, as recognized by the FSB.

Many large banks have training programs for their correspondent relationships but are limited by the scale of the issue and the locations of respondents. Such programs are at best complementary to local supervision and regulatory requirements.

Governments, policymakers and the industry should explore whether a more centralized and structured training program could be developed by the relevant parties in conjunction with, and delivered by, the appropriate international organizations.[26] Consideration should be given to creation of a certification by official-sector bodies upon which banks could rely, absent manifest indications to the contrary.

5. **Enhanced due diligence measures** (Para. 26*): please clarify if, in addition to the interaction with the target respondent institution's management and compliance officer(s), financial institutions can and do also get information from a foreign supervisor in practice?*

[24] For additional discussion on the KYCC issue, please see section 9(d) of this comment letter.

[25] CPMI, *Correspondent Banking*, July 2016, pp. 27-29 and IIF, *Letter to the FATF on facilitating effective sharing of AML/CFT information*, May 25, 2016: https://www.iif.com/publication/regulatory-comment-letter/iif-submits-letter-effective-information-sharing-amlcft

[26] We note that there has been significant discussion globally on training and capacity building. The FSB has, for example, emphasized the need for domestic capacity-building in jurisdictions that are home to impacted respondent banks. We strongly believe that the public sector should, as the FSB states, "work with jurisdictions to address deficiencies that pose a risk to the international financial system and provide extensive technical assistance to member countries to enhance their supervisory and regulatory frameworks" as well as take the lead in providing training on AML/CFT compliance expectation to respondent banks in particularly effected regions. FSB: *Report to the G20 on actions taken to assess and address the decline in correspondent banking*, November 6, 2015, pp. 8-9.

Typically, correspondent banks' relationship managers raise relevant questions during regular conversations or when concerns are specified from a compliance perspective. Having answers from a business representative can indicate implementation of a national compliance framework. When undertaking enhanced due diligence on correspondent relationships, banks critically assess the robustness of the respondents' financial crime risk management programs, as this will determine whether the respondent can be accepted for a full or more limited relationship.

Currently, soliciting information from a foreign supervisor is only done in exceptional circumstances. In many cases, it is not evident how helpful soliciting such information would be, except as to general policies and procedures available elsewhere. Supervisors will often be impeded by information-sharing restrictions from providing genuinely useful information. We would be concerned, moreover, if there were a requirement for banks to source information from foreign supervisors as part of due diligence practice; rather there should be the option to do so in a reliable manner when deemed appropriate and useful. It would be inappropriate to mandate the need to seek additional information not in the public domain; any compulsory requirement along these lines could well lead to additional pressure on the compliance cost of maintaining the correspondent relationship while gaining little in the way of probative value.

It also is important to stress overall in reference to Paragraph 26 that previous approaches to regulation and supervision made enhanced due diligence only necessary in high risk cases. It is clear, however, that the current regulatory approach shifts the weight of responsibility onto the banking sector in a way that increases the burdens on banks to an extent that leads to the reconsideration and termination of many correspondent banking relationships that would proceed if there were clarity about banks' ability to rely in good faith on the regulatory environment and clear regulatory expectations.

6. Ongoing Transaction Monitoring (Para 30): *please provide information on the types of relationships for which sample testing is conducted and how the sample testings are conducted in those cases*

Most correspondent banks usually screen all respondent transactions against red flags that are indicators of potential money laundering. Although regular reviews with sample checks are done in the ordinary course of business, there is no clarity on what the expectations around sample testing entail. Generally, when sample testing is done it includes a review of certain transactions and business as executed.[27]

Greater clarity on what sample testing entails in the correspondent banking context, and specifically in the context of ongoing transaction monitoring, will be important to ensure financial institutions are fully able to comply with the requirements of the process. Understanding of what is expected is, once again, important to limiting incentives to de-risking.

[27] This can include a review of parties to the transaction, amounts involved in the transaction, geographies involved in the transaction, verification with source documents, verification of AML/sanctions compliance checks, and verification of adherence to international rules (*e.g.* UCP 600), internal policies/procedures and local regulations.

7. **Ongoing Monitoring and Request for Information About Transactions** (Para 34): *please confirm that the list in Paragraph 34 is appropriate and reflects business practices*

We believe the list in Paragraph 34 generally reflects the issues considered in the ongoing monitoring process, but also encompasses a level of detail that would be too prescriptive if made compulsory. Not all relationships require the level of ongoing monitoring envisioned by the questions and explicitly or implicitly mandating use of every question on the list could stray close to the application of KYCC.[28] Instead, banks should be able to rely on the list as directionally appropriate but the actual monitoring process instead should focus on relevant questions insofar as necessary to handle any issues seen with the relationship and counterparty so they can be addressed directly. It should be made clear to supervisors and enforcement authorities that the list is not intended to be prescriptive and that banks need to be free to make reasonable, good-faith judgments as to what is required in each case.

Questions also arise as to the use of the term "duration" in the list as a determining factor of a customer's relationship with a respondent institution.[29] We query whether a newly on-boarded relationship is implicitly considered by the FATF to be safer than a long-standing relationship. Similarly, it is unclear if the source of the customers' funds must be considered in general or in detail.[30] These examples may imply banks are required to collect disproportionate volumes of information not necessarily relevant to ongoing monitoring. This could lead to a level of unneeded additional activity that would increase costs and deter continuing business, with no real value to the compliance process.

8. **Request for additional information on MVTS customers** (Para 45): *please clarify if, when the respondent processes the transactions of its customers on a group basis, the correspondent institution usually gets access to the identity of the respondent's underlying customers following a request for additional information.*

The IIF understand that MVTS customers usually undergo enhanced due diligence similar to money services businesses and third party payment processor customers.

It is helpful that the FATF states in paragraph 45 that "there is no obligation … to apply CCD measures to the customers of the MVTS". But this seems to be contradicted by the last sentence of paragraph 45,[31] and paragraph 48. Once appropriate due diligence is done on an MVTS a

[28] For additional discussion on the KYCC issue, please see section 9(d) of this comment letter.

[29] "Duration of customer "X" relationship with the respondent institution and whether the respondent institution classifies the customer as a high risk customer": FATF Draft Guidance, Paragraph 34.

[30] Source of the funds of customer "X": IBID, Paragraph 34.

[31] "The correspondent institution should get access to both the settlement and information flows associated to the payment chain in which the respondent institution is involved, monitor the whole circuit of funds (from the moment they are received from the payers until they are transferred to the payees), and be informed on all entities involved.": FATF Draft Guidance, Paragraph 45.

bank should be able to rely on that, plus the fact that the MVTS itself should be subject to the same standards as a bank when providing similar services, as discussed above.

Ability to rely on the MVTS is particularly important (and would have important inclusion implications) where an MVTS is part of a credit-card or mobile-phone payment scheme, or where an MVTS provides payment services to merchants or other third parties. Once again, despite the good intentions and statements such as the one just quoted, the language of paragraphs 45 (particularly the last sentence) and 48 are likely to create more incentives to de-risking and do not really provide helpful guidance to banks confronted with demand for services by "fintech" companies or other innovators. Paragraphs 45 and 48 need to be adapted to the realities of new, innovative, and generally high-volume businesses. Such businesses often aim at taking specific tranches of payments or other businesses away from banks, and it will not be sustainable for the AML/CTF burdens and liabilities to be left primarily on the banks.

Moreover, in the European Union, these paragraphs fit uncomfortably with the obligations imposed on banks to allow third-party providers access to accounts under Payment Services Directives 1 and 2. These are issues that should be confronted now, and not deferred as the present text seems to do.

In addition, paragraph 46 may in some cases reflect good practice in segregating certain accounts of MVTS providers, but it may be hard to apply in real life in many cases. Although a bank may agree with an MVTS provider to offer different accounts for different types of businesses, if paragraph 46 is taken as a requirement, it may be difficult to decide what the difference is between "settlement activities" and "correspondent banking services", given that MVTS businesses may operate on a net-settlement basis on their own books and therefore underlying cash movements through banks do not reflect specific underlying customer payments.

Where a bank sets up specific accounts with an MVTS for "higher-risk activities" or "higher-risk customers" it will need to be entitled to rely in good faith on the agreement of the MVTS to channel the designated business through such accounts. Absent red flags, it is hard to see how a bank could police an MVTS's compliance with such agreements. Moreover, it should be noted that any requirement for such segregated accounts (and hence segregated payment channels at the MVTS level) will add to both its and the banks' costs, complexity and compliance risk, once again creating a burden on inclusion and an incentive to de-risking.

9. Other Issues

In reviewing the draft guidance, we have also identified a number of other issues for consideration, which we consider to be of equal importance with those addressed above:

a. De-risking Definition

The draft guidance perpetuates FATF's initial definition of "de-risking" as "situations where financial institutions terminate or restrict business relationships with entire countries or classes of customer in order to avoid, rather than manage, risks in line with the FATF's risk-based approach ("RBA")." [32] The draft guidance later acknowledges the complexity of the causes of "de-risking"

[32] IBID: Paragraph 1 and Footnote 37.

in ways that would appear to recognize that the issue is not one of improperly avoiding risks.[33] The existing FATF definition of de-risking encompasses a very narrow segment of the causes of the overall de-risking issue. Adopting a more realistic definition, and specifically one that also removes the unnecessarily pejorative references to banks' intentions, will better focus the discussion on real causes and appropriate solutions.

The IIF believes a more targeted definition would be appropriate and may entail the following: *The term "de-risking" has become common shorthand for referring to any instances in which banks have adopted increasingly stringent financial crime-related policies to reduce their exposure to potential money laundering, terrorist financing, corruption or sanctions risk. More specifically, it relates to the strategies adopted by banks to reduce or eliminate their risk exposure. The term tends to be used particularly where multiple businesses in a given category or country are affected.*

b. Limitation or Restriction of Services

Paragraph 43 states that "in any event, correspondent institutions should clearly communicate their concerns to respondent institutions, at senior management level, and inform them of their concerns and the measures needed to address these concerns as a condition to maintain the correspondent banking relationship."

This may imply creating a special framework by the correspondent bank for individual respondents and, as efficiency as well as effectiveness in today's market environment requires as much standardisation as possible; this may incur a cost that is prohibitive for the maintenance of the relationship. Furthermore, the process implied by Paragraph 43 may actually increase regulatory and reputation risk for correspondents as it implies delay in restricting or cutting off relationships that may have become dubious.[34]

c. Shell Banks

In Paragraph 20, the draft guidance states, "The correspondent institution should be satisfied that the respondent institution does not intend to permit its accounts to be used by shell banks." It certainly would be relevant if a respondent did intend to permit its accounts to be used by shell banks. Correspondent institutions should be given clear guidance as to what is sufficient to establish such satisfaction. We would suggest an initial and periodic assessment of the controls that the respondent institution has implemented to ensure that its accounts will not be used by shell banks would be sufficient.

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[33] IBID, Paragraphs 2-7; In addition, it has been widely recognized that de-risking is a complex problem with multiple drivers. For example, the IMF has stated "Individual banks may decide to withdraw correspondent banking relationships ("CBRs") based on a number of considerations…. such decisions reflect banks' cost-benefit analysis, shaped by the re-evaluation of business models in the new macroeconomic environment and changes in the regulatory and enforcement landscape….. Further pressures to withdraw CBRs may arise where regulatory expectations are unclear, risks cannot be mitigated, or there are legal impediments to cross-border information sharing." (IMF: *The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action*, June 2016, p.5) and the UK Financial Conduct Authority ("FCA") has recognized, *inter alia*, higher compliance costs and increased prudential capital and liquidity requirements as contributing factors to the de-risking phenomenon (FCA, *Drivers and Impacts of De-Risking*, February 2016, Sections 3 and 4).

[34] Similar issues come up with respect to Paragraph 42; please see the discussion below.

d. Know your Customers' Customer

We strongly emphasize that clarity is needed from regulators that there are no requirements to conduct KYCC - in line with FATF statements.[35] The draft guidance acknowledges in Paragraph 2 that the confusion caused by KYCC questions has contributed to the incentives to "de-risking". However, the consultation still contains mixed messages on KYCC. It is important to be very clear about regulatory expectations this area. [36]

Third party activity means that banks have an indirect exposure to their respondents' customers' behavior, without knowing anything about such parties. The summaries in Paragraphs 3 and 4 illustrate the problems that have led to the widespread perception of KYCC: "There is no *general* expectation … for the customer institution to conduct due diligence on their customers' customer at any time …" and "It was clarified that the *FATF Recommendations* do not require correspondent institutions to perform CDD on the customers of their respondent institutions *as a matter of course …"*. There is a clear implication that KYCC isn't required, except when it is. Despite good intentions and some helpful language, the draft guidance does not overcome this implication. There continues to be a perception that not having carried out KYCC will be seen as a lapse if misconduct is subsequently discovered. Regulatory expectations need to be clearly articulated.
For example, while the draft guidance adheres to the position that "KYCC" is not a requirement or a recommendation, Paragraph 21 seems to require an open-ended assessment of the respondent's customer and the nature and level of the risk they pose, which sounds like KYCC. In particular, the recommended steps for nested relationships and payable-through accounts in Paragraph 21 have many indicia of KYCC. A very high standard is set for understanding such relationships and accounts, one that is completely open-ended and enhances rather than defines potential exposures for correspondents. The recommendations for nested relationships and payable-through accounts, juxtapositioned against the general no-KYCC position, diminish rather than enhance clarity of regulatory expectations.

Without further explanation, Paragraph 23 seems to set a very explicit and rather high standard of KYCC, which, again, will enhance rather than contain incentives to de-risking.

Paragraph 31 is helpful on the KYCC point, but insufficient in itself to overcome the hesitation and insecurity caused by the perception of regulatory risk from apparent KYCC expectations.

Lastly, Paragraph 34 again establishes what seem to be very demanding requirements for information about customers of respondents: "sources of funds", "possible affiliations", "etc." "Possible" affiliations and other such terms seem entirely elastic and thus susceptible to generating concerns that these requirements will be looked at with 20-20 hindsight, thereby creating risk of regulatory or enforcement actions that will be hard to manage other than by terminating relationships.

e. Understanding the Respondent Institution's Business

[35] "It was also clarified that the FATF standards do not require a "know-your-customer's-customer" ("KYCC") approach to conducting customer due diligence." FATF Private Sector Consultative Forum Meeting, March 2015.

[36] For further information on KYCC ambiguity in the draft guidance, please see sections 2, 4, 7, 9(e) and 9(f) of this comment letter.

We believe the requirement in Paragraph 22 that the "correspondent institution should also gather sufficient information to fully understand the nature of the respondent institution's business" may lead to lack of clarity on what standards actually apply. The use of the term "fully" could be interpreted as meaning a zero-tolerance approach to any lack of insight into a respondent institution's business. As "fully" is a standard that is hard to meet, the draft guidance should make it clear that correspondent institutions should be expected to comply in good faith with the terms outlined in Paragraph 22 but that there is no expectation that compliance review should stretch beyond that or into the realm of KYCC.[37]

f. Verifying Customer Information

Paragraph 26 states that, in line with FATF Recommendation 17, "Where the correspondent institution is permitted to rely on other banks (that may already have a correspondent relationship with the respondent institution) they should ensure that the CDD information relied on is obtained, be satisfied they can obtain supporting documentation, be satisfied the bank being relied on is regulated and has measures in place that are reliable." We believe this could be again interpreted as straying into a grey area where KYCC is expected in the due diligence process.[38] We believe the draft guidance should make clear that FATF Recommendation 17 does not require a measure of due diligence outside the direct relationship between the correspondent bank and its own customer (and that the same principles should apply where the respondent relationship is with an MVTS business).

g. Ongoing Communication and Dialogue

Though we understand the goals of paragraph 39 in trying to mitigate the unnecessary closure of correspondent accounts, we fear the prescriptive nature of the paragraph goes too far in creating a special framework by the correspondent bank for individual respondents. As noted in our commentary on Paragraph 43, efficiency as well as effectiveness in today's market environment requires as much standardization as possible. The requirements in this section may demand a cost that is prohibitive for the maintenance of the relationship and actually lead to further reevaluation of some business areas. Additionally, the paragraph implies that the correspondent bank would need to add an additional layer of due diligence and ongoing monitoring to that which is already required by the FATF Recommendations and the draft guidance. If financial institutions are able to rely on compliance with the accepted standards, the current dialogue and communication required should be sufficient to ensure the appropriate level of monitoring needed to determine the safety and viability of the correspondent banking relationship.

The IIF does, however, applaud the intent of Paragraph 40: it is very important for regulators and supervisors to maintain an open dialogue with correspondent institutions to clarify what the regulatory and supervisory expectations are regarding the requirement to conduct due diligence on respondent institutions. This is essential and needs to be institutionalized to obtain the necessary clarity of expectations. We believe such forms of dialogue should include enforcement agencies in the relevant jurisdictions to ensure to full engagement of all stakeholders. The Joint

[37] For additional discussion on the KYCC issue, please see section 9(d) of this comment letter.

[38] See footnote 36 of this comment letter.

Money Laundering Intelligence Taskforce ("JMLIT") in the United Kingdom is a good example of how such fora can be instituted in an effective manner.

h. Adjusting Mitigation Measures to the Evolution of Risks

We agree that in line with Paragraph 42, due diligence requirements should be tailored to the risk levels associated with the correspondent banking relationship and adjusted as necessary in line with the appropriate standards. However, we also believe as outlined in the FATF Recommendations[39], customer relationships should be terminated where identified risks cannot be managed on a reasonable basis in line with the risk-based approach. The result of the possible intent of Paragraph 42 may be to delay termination of a relationship even when the probity of that relationship has become highly uncertain (as discussed above, the same problem arises given the language of Paragraph 43). Affirmation of the current risk-based approach and reliance on regulatory clarity in the terms of the FATF recommendations and the draft guidance should be sufficient to assess the business underway. Any prescriptive delay in closing correspondent accounts that may be impaired could lead to reputational damage and inhibit the opening of certain accounts in the first place.

[39] FATF: *The FATF Recommendations*, February 2012 (Updated June 2016), Recommendation 10, Paragraph 7.